No. 92-1186

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

JOHN J. WATERS and JEANNE M. WATERS,

Petitioners,

—v.—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONERS' REPLY TO RESPONDENT'S BRIEF IN OPPOSITION

STEPHEN D. GARDNER
Counsel of Record
ANN-ELIZABETH PURINTUN
PETER L. ENTE
KRONISH, LIEB, WEINER & HELLMAN
Attorneys for Petitioners
1345 Avenue of the Americas
New York, New York 10105-0202
(212) 841-6000

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ARGUMENT

Respondent correctly notes (Opp. Br. 10) that effective for tax years beginning after December 31, 1986, section 469 of the Internal Revenue Code requires certain taxpayers to defer deductions for losses from "passive" trade or business activities to the extent such losses exceed their aggregate income from "passive" trade or business activities. Respondent also correctly notes (*id.*) that a "passive activity" is an activity that

involves the conduct of a trade or business in which the taxpayer does not materially participate. 26 U.S.C. § 469(c)(1).

In amending the Internal Revenue Code to include the passive activity loss limitations of section 469, Congress did not repeal the "at-risk" rules of section 465. Respondent's assertion (Opp. Br. 11) that the section 469 passive activity loss limitations have "effectively displaced" analysis under section 465 is wrong. Section 469 presents an additional limitation on the deductibility of losses, not a substitute one. If a taxpayer is at risk with respect to a passive activity, section 469 applies to limit the deduction for losses from that activity (and other passive activities) to the aggregate amount of income generated by all passive activities during the tax year.

It is incorrect to conclude, as Respondent does, that "The question addressed in this case, and in [*Emershaw* v. *Commissioner*, 949 F.2d 841 (6th Cir. 1991)], would thus be inconsequential with respect to an identical transaction entered into after December 31, 1986." The question presented in this case, and in *Emershaw*, would not be inconsequential with respect to a taxpayer who had income from other passive activities. Contrary to Respondent's assertions, the importance of resolving the conflict among the circuits concerning the application of section 465(b)(4) to the facts of this case has not been negated by the addition of section 469 in 1986. The at-risk rules of section 465 remain of continuing significance to both taxpayers and the Treasury.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

/s/ Stephen D. Gardner
STEPHEN D. GARDNER
Counsel of Record
ANN-ELIZABETH PURINTUN
PETER L. ENTE
KRONISH, LIEB, WEINER & HELLMAN
Attorneys for Petitioners
1345 Avenue of the Americas
New York, New York 10105-0202
(212) 841-6000

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